

VZCZCXRO1987
PP RUEHLMC
DE RUEHTG #0892/01 1412326

ZNY CCCCC ZZH
P 212326Z MAY 07
FM AMEMBASSY TEGUCIGALPA
TO RUEHC/SECSTATE WASHDC PRIORITY 5872
INFO RUEHZA/WHA CENTRAL AMERICAN COLLECTIVE PRIORITY
RUEHCV/AMEMBASSY CARACAS PRIORITY 0559
RUEHME/AMEMBASSY MEXICO PRIORITY 7533
RUCPDOC/DEPT OF COMMERCE WASHDC PRIORITY
RHEBAAA/DEPT OF ENERGY WASHDC PRIORITY
RUEAWJA/DEPT OF JUSTICE WASHDC PRIORITY
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY
RUEAIIA/CIA WASHDC PRIORITY
RHEHNSC/NSC WASHDC PRIORITY
RUEHLMC/MILLENNIUM CHALLENGE CORP WASHINGTON DC PRIORITY 0651
RUEHUNV/USMISSION UNVIE VIENNA PRIORITY 0082

C O N F I D E N T I A L SECTION 01 OF 03 TEGUCIGALPA 000892

SIPDIS

SIPDIS

STATE FOR EB/ESC, WHA/EPSC, WHA/PPC, AND WHA/CEN
STATE FOR D, E, P, AND WHA
TREASURY FOR DDOUGLASS
STATE PASS AID FOR LAC/CAM
NSC FOR DAN FISK

E.O. 12958: DECL: 05/21/2017

TAGS: ENRG EPET HO PGOV PINR PREL

SUBJECT: HONDURAS: TWIN SHOCKS IN ENERGY MAY HIT THIS SUMMER

REF: TEGUCIGALPA 368 AND PREVIOUS

Classified By: AMB Charles Ford for reasons 1.4 (b) and (d).

1.(C) Summary: While the Honduran initiative to nationalize all fuel imports and award one contract to supply the country's fuel needs appears to have stalled, problems persist. The current fuel importers have declared they are operating at a loss, and have told Post that they will not continue to increase the supply in-country, which would lead to fuel shortages within the next two to four months. Meanwhile, huge financial losses continue to mount at state electrical company ENEE, and sources have indicated that black-outs could hit the industry heavy north within four months. The response from the President may avert short term disasters, but with long term repercussions. End Summary.

FUEL IMPORTERS: 12 CENT LOSS ON EACH GALLON

12. (C) Ambassador and EconChief met with Exxon representatives April 23, after the group had first met with President Jose Manuel "Mel" Zelaya. In the meeting the reps described how the change in the fuel price setting formula effected last January 15 (reftel) has forced the company to operate at a loss. The company has proposed raising the margins on imported fuel over the course of several months to allow them to operate profitably; without this mechanism in place, the reps indicated that they simply would not increase their supply of fuel to meet the rising demand, particularly for premium fuel. (Comment: With fuel prices at historic highs, Post sees little possibility of President Zelaya agreeing to recoup the estimated 12 cents in importer margin by increasing gasoline prices. End Comment.)

13. (C) The demand for fuel over last year's quantities has risen over 20 percent despite the high prices. (Comment: Industry observers are mixed on why this is happening. Most attribute the growth to more motorists staying in Honduras to fill their tanks as regional prices equalize. End Comment.) Per the importers, because they are losing the 12 cents per imported gallon, they will face a decision around the end of

July on whether to restock their storage facilities at the higher level required to meet the demand. Exxon has stated that unless their demands are met they will not, which could potentially leave some of their 57 branded stations without fuel. (Comment: It is difficult to believe that Exxon would allow their stations to run out of supply, and potentially damage their brand name over a dispute in a relatively minor market. However, keeping current contracts at the same supply level is a distinct possibility. Post believes that they are most likely in a loss position on importing, but exactly how much of a loss and whether they make up for that loss on other parts of the distribution chain is debatable. End Comment.)

¶4. (C) In a meeting April 28 with fuel importers Texaco and Shell, the companies also stated that, faced with increasing demand in the early summer, they will likely decide not to increase supply. Moreover, the Shell reps maintained that, due to a change in diesel type used in the PLATS fuel reference pricing system, the importers will soon be facing another difficult negotiation with the GOH on changing formula reference prices. (Comment: PLATS, a regional price reference used in the GOH price setting formula, is changing from using an older diesel blend, Diesel #2, to a low sulfur blend that costs more. Consequently, the GOH and the importers need to come to an agreement over how to adjust the formula to accommodate the new PLATS price. End Comment.) The importers maintain that this is the same type of issue that allowed the GOH to change the formula (and put importers in a loss position) when the reference price for premium fuel changed in January.

TEGUCIGALP 00000892 002 OF 003

ENEE) BLACKOUT THREAT GROWING RAPIDLY

¶5. (C) Meanwhile, the other side of the energy equation, power generation and distribution, is a fiscal and technical disaster. With over 70 percent of energy generation produced by thermal energy (diesel and bunker, or fuel oil), the company's costs have risen dramatically in the last two years. In addition, while several old thermal generation contracts negotiated at rates as high as 18 cents per Kilo Watt Hour (KWH) have recently been renegotiated, the overall fiscal impact reportedly remains the same. (Comment: Competitive rates for a market the size of Honduras are usually in the 6 to 8 US cent range. EconChief met with one thermal plant owner, Freddy Nasser, who proudly announced he had simply renegotiated longer terms and higher prices on other plants to achieve the same net price. End Comment.)

¶6. (C) Faced with skyrocketing costs, the GOH has shown little political will to raise consumer rates. The first head of ENEE in the Zelaya administration, Juan Bendeck, made the recommendation to raise rates within his first days of office) he was fired soon after. Consequently, financial losses have been estimated at around USD 200 thousand a day, and sources at the Finance Ministry indicate that keeping ENEE solvent will require an exceedingly high percentage of the national budget. A high profile operation to collect on deadbeat subscribers, companies and government agencies, called Project Scissors and led personally by President Zelaya, was generally considered ineffective. But the near term issue is finding sufficient energy generation capacity, and industry sources estimate that within 6 months ENEE will face continual blackouts if 70 to 100 Mega Watts (MW) of new capacity is not found. (Comment: Blackouts in the northern coast town of La Ceiba have already been reported. End Comment).

¶7. (C) ENEE representatives have officially stated that they need 100 MW of new capacity by summer 2008 to maintain at least a 10 percent reserve of installed capacity, but industry sources indicate that the deteriorating

infrastructure and maintenance requirements are accelerating the need for new capacity. Loss of energy due to bad lines and other equipment is estimated at around 28 percent, well above the industry average of 10 to 15 percent. Insufficient investment in the sagging infrastructure means that the situation will not improve in the near future. Complicating matters is the need for increased maintenance on the aging equipment, particularly the No. 4 turbine at the big 300 MW dam El Cajon, which should have been brought down for scheduled work months ago.

18. (C) With the financial and technical outlook for ENEE dire, plans to close the near term gap in capacity have been largely ineffective. Bids for two new thermal plants in the north returned rates of 19 cents per KWH and were dismissed. It now appears the only option to avoid blackouts by the end of summer is to negotiate once again with the current thermal plant owners. (Comment: Nasser and fellow thermal plant owner, and brother-in-law, Chukry Kafie, have offered to expand capacity at their plants at an undisclosed rate. Another option is an aged and shuttered thermal plant in Puerto Cortes that could generate around 60 MW after significant retrofitting. Industry observers are not surprised that Nasser and Kafie are seemingly the only options in town, and blame them for GOH inaction in securing new sources of energy. End Comment)

19. (C) COMMENT. With the GOH heading for another show-down with the fuel importers, the ENEE situation makes the situation much worse. President Zelaya's playbook for dealing with refined gasoline issues: stare down the multinationals, freeze prices at random levels, and give the public the impression that he can control prices - has helped keep his public approval numbers high. In this environment it is hard to believe Zelaya will give back any of the

TEGUCIGALP 00000892 003 OF 003

importer margins gained in the January 15 formula change. U.S. companies Exxon and Texaco will most likely acquiesce in this scenario, but Shell is a different story: with the least infrastructure in country of the three, and divestitures in the Dominican Republic, they might decide to pull-out.

110. (C) COMMENT (CONT): ENEE on the other hand is a more formidable challenge; Zelaya cannot as easily pin the blame on the thermal generators or other groups. With Project Scissors gaining little in the polls and even less for ENEE, President Zelaya will most likely turn to the thermal owners to meet short term capacity needs. That has happened before, in the early 1990s, and the thermal owners are benefiting from that windfall up to this day. While the twin shocks in refined gasoline and power generation may be avoided, it could come at the expense of higher prices and greater industry consolidation. END COMMENT.

FORD